

**Remarks of  
Commissioner Linda K. Breathitt  
Federal Energy Regulatory Commission**

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Good Afternoon. It's an honor to be with you today in such a beautiful setting and with this august gathering. I appreciate the invitation to present my views on the North American energy market from the perspective of a U. S. energy regulator.

It is interesting to note that the U. S. and Canada are on similar paths toward the restructuring of energy markets and regulatory systems. And as such, we are experiencing some of the same benefits and perhaps some of the same challenges. Our two countries enjoy and depend on a cooperative and friendly relationship regarding the trading of electricity and other energy products. This is so important, especially during the transitional period we find ourselves in. Canadians and Americans live in a common energy marketplace and, therefore, will benefit from the efficient and economic operation of our interconnected energy systems.

Electricity markets have never been as vibrant and complex as they are today. What we are seeing in the United States—and what I believe you are seeing in Canada—is an unprecedented volume of trading by many new types of entities, from power marketers and brokers to independent power generators. However, the new electric marketplace brings with it some new complications and challenges which regulators and policy makers must address.

In the United States, the federal government has been balancing these new opportunities and challenges for several years as we continue to open the wholesale electricity markets to competition. In addition, many U. S. state governments—just like

some provincial governments in Canada—are grappling with these difficult issues as they open their retail markets to competition.

In 1996, the Federal Energy Regulatory Commission issued two groundbreaking orders, Order Nos. 888 and 889, which established the foundation for competitive wholesale power markets in the United States. With these rules, the Commission ordered all transmission-owning public utilities to open up their transmission systems to allow them to be used on a non-discriminatory basis by all wholesale electricity customers. The Commission's goal was to ensure that customers have the benefits of competitively priced generation.

In the five years since those Orders were issued, several significant developments have occurred in the U. S. electric utility industry. These include: the rapid development of planned generation resources; the tremendous growth in the volume of electricity trading; new stresses and strains that are being placed on the transmission system and on new electricity markets; and the formation of Regional Transmission Organizations.

First, the availability of open access tariffs and more transparent information about transmission capacity and prices have fostered a growth in planned generation resources in certain areas. This is an important development for regions such as the Northeastern area of the United States, which includes New England, New York, and parts of the Atlantic Seaboard.

When the Commission issued its orders in 1996, this region suffered from a lack of generation supply. Now, approximately 25,000 megawatts of generation is expected to come online by 2002. This new capacity is coming almost entirely from independent generating plants (or merchant plants) which are now able to sell power into the bulk market through open access to the transmission system.

A second development resulting from electric restructuring has been the significant growth in the volume of trading in the wholesale electricity markets. This new growth is coming primarily from power marketers and independent generators. According to regular filings made by power marketers to the Commission, in the first quarter of 1995 sales of almost 2 million megawatt-hours were reported by eight active power marketers.

By contrast, during the second quarter of 2000, such sales escalated to over 423 million megawatt-hours, and trading was performed by over 110 active power marketers. The sheer increases in trading volumes and the number of entities trading in the marketplace have been dramatic. These increases in wholesale marketing volumes are attributable, in part, I believe, to the dramatic increases in merchant power generation development. Because these plants generate electricity solely for sale in the competitive wholesale market, expansion of this field will drive growth in the power marketing industry. Unfortunately, the development of new generation is not consistent nationwide. For instance, in California the lack of new generation is a major reason for the current energy crisis in that state.

The benefits that have resulted from these soaring sales figures and increases in planned generation capacity, have come with a price. We are seeing new stresses and strains being placed on the transmission grid by the increased usage of the system and we are experiencing extreme price volatility in the Western states.

Regulators today are called upon to achieve a delicate balance in the emerging competitive marketplace. FERC must continually gauge these fledgling markets to determine when to stand back and let market development take its course, and when it is necessary to take action to address specific circumstances. Achieving that balance is the common thread that runs through most of FERC's deliberations these days.

The price spikes and volatile bulk power markets confronted by California consumers for the past months illustrate the kind of regulatory challenge FERC faces with respect to markets that are not yet mature. This energy crisis is affecting the lives and well-being of millions of citizens and threatening the existence of thousands of businesses.

In managing situations such as this, FERC must decide when it is necessary to take immediate, short-term actions, such as the imposition of price caps, and when to forge ahead with our long range regulatory goals that will lead to economically sound and lasting solutions. We find ourselves in such a dilemma at the present time.

Price intervention by FERC can easily send the wrong signal to the market. That is why FERC must be very careful in this regard. Price caps can exacerbate a troubling situation that currently exists in the California market—a shortage of energy supply—by discouraging generators from serving the markets. I believe we must find ways to encourage supply into the market and to ensure a sufficient generation and transmission infrastructure, so that the market is healthy in the long run. Having said that, however, I also believe that the limited use of price caps can be appropriate in the imperfect markets we are seeing today if they are carefully structured, temporary and come with certain conditions. I view such price caps as a bridge to competition. If price caps help get us where we want to be—into well functioning competitive markets absent of heavy-handed regulation—then they could serve as a useful transition tool.

Just as volatile electricity prices are dominating the Commission's attention these days, public reaction to the high cost of natural gas this winter is also at the forefront. Due to the continuing convergence of the electric and natural gas industries, problems that have affected the electric utilities in California and the West also have been felt in natural gas markets. The problem of insufficient generation capacity in California implicates also the issue of natural gas supply since virtually all new generation is expected to be gas-fired. The interplay between the electricity and natural gas markets

figures prominently in our minds as the Commission develops its ongoing response to current market disruptions.

Canada is playing an increasing role as the United States seeks to increase electricity generation. Not only does the U.S. import electricity from Canadian hydroelectric projects; the Canadian natural gas industry has become a prominent force on the United States energy scene. Just in the past few years, there has been considerable development of gas interconnections between Canada and the U.S. The Northern Border Pipeline, which began operating in late 1999, connects to Chicago through the upper Midwest. At the end of last year, the Alliance Pipeline—the longest pipeline ever built in North America at 1,875 miles—began to transport 1.3 Bcf/d of gas from Western Canada to the Chicago area. Gas from Sable Island now serves New England through the Maritimes and Northeast Pipeline; and gas from British Columbia is imported by the U.S. utility Pacific Gas & Electric. All of these projects have changed the dynamics of the U.S. natural gas marketplace and this country's energy mix in a positive way for both our countries.

While the volatile natural gas commodity prices are not subject to price regulation, FERC plays a significant role, through our pipeline certification procedures, in ensuring that sufficient pipeline infrastructure exists to deliver natural gas to meet increasing demand. Turning back for a moment to the current situation in California, it appears that gas demand may exceed the natural gas transportation system capacity in the state. Thus, not only is there a need for additional investment in generation facilities; there also may be a need to increase natural gas reliability in the region. FERC's jurisdiction in this regard, however, is limited to certifying interstate pipeline capacity. It is becoming increasingly apparent that the availability of intrastate pipeline capacity in California needs to be reassessed. Siting of intrastate pipelines is a matter for the California authorities. With the growing demand for natural gas in electric generation and the high likelihood of a pipeline from Alaska being built, I believe that the natural gas infrastructure requirements of the entire region must be reassessed. Canadian officials

will certainly be engaged in this reassessment as the siting process unfolds. FERC has been involved in an ongoing effort to streamline the certificate process to ensure that we are able to do our part in responding to the growing demand for natural gas nationwide.

One of the lessons learned in the California electricity crisis applies equally to natural gas markets, and it is one that I believe bears repeating. There appears to be an over-reliance on spot-market purchases of natural gas. I believe that regulators need to be careful to discern the difference between hedging to reduce exposure to price volatility, and mere speculating. Hedging can be a useful tool to decrease uncertainty, while speculating on the market can increase the likelihood of risk. It could even be said that failing to hedge, and thereby failing to limit the exposure to the vagaries of the spot market, is actually speculating. Only if regulators are careful not to encourage an over-reliance on the spot market can the long-term health of natural gas markets be assured.

As price volatility and market dysfunction are causing a consumer backlash against newly restructured electricity markets, regulators are beginning to sense an emerging public concern about restructured natural gas markets. At FERC, there is renewed public attention to our removal of price caps in the short-term secondary pipeline transportation market. The price cap regulations were waived until September 30, 2002. We have been asked to reconsider the waiver and its effects in California gas markets. While this issue is the subject of an ongoing complaint proceeding on which I cannot comment, I bring it up to illustrate the waning confidence in competition as a means to protect consumers. I believe we will be under continued pressure to retreat from our pro-competitive policies until prices in all sectors of the energy market become more stable.

The circumstances in California electricity markets have been disturbing. Consumers have been experiencing the price volatility and uncertainty of imperfect wholesale electric markets. This is sending shock waves through the U. S. electric industry that threatens to impede the continued progress that has been made in restructuring the industry. Regulators must ensure that California is not the catalyst for a

retreat away from the goal of transforming the industry into a competitive and open market. I continue to believe that robust competitive wholesale bulk power markets are attainable—by moving forward, not retreating—and by taking firm steps to address the market imperfections.

In order to do so, however, I believe that FERC must concentrate its efforts primarily in two areas. First, we must expand and enhance the Nation's transmission system and ensure that it is efficient and that access to it is open and non-discriminatory. Second, we must concentrate on increasing the supply of electric energy in the markets.

First, with regard to transmission expansion, the electric delivery system that exists in the U. S. today was never intended to carry the volume of electricity that is currently being traded. This system was originally constructed by vertically-integrated utilities to move power from their generating plants to their customers. It was never envisioned to carry the amount of interstate transactions occurring today. This increased trading volume is leading to congestion and could be a threat to reliability.

Obviously something needs to be done to enlarge and upgrade the Nation's electric transmission system. Unfortunately, FERC currently lacks specific authority under the Federal Power Act to site new transmission facilities. This is the area in which we must rely on our colleagues at state commissions who possess siting authority. In the past, I have been comfortable with that restriction on FERC's siting authority, preferring to maintain the existing role of State authorities in the siting of these facilities. However, my thinking on this issue has changed. I believe the shortage of available transmission capacity has become a national issue involving interstate commerce. Therefore, FERC must have a greater role in the siting of new transmission infrastructure. The continuing good health of our Nation's economy depends on a free-flowing supply of electricity. That won't happen unless there is an adequate amount of available transmission capacity.

Expansion of generation capacity is the second major area where additional efforts must be undertaken. The North American Electric Reliability Council (NERC) has estimated that more than 10,000 megawatts of capacity nationally will have to be added each year between now and 2008 to keep up with the growth in demand. However, the Electric Power Supply Association stated in a report last summer that actual capacity additions since 1990 have been averaging only about 7,000 megawatts per year. This growing supply deficit will likely become a serious problem in the near future. For this reason, FERC and state commissions must focus on facilitating the addition of new capacity, as well as increasing the availability of demand response programs and services. We must strive to narrow the gap between the supply of electricity and the ever-increasing demand for electricity.

In all of these matters, there is an increasing awareness of the important opportunities for cross-border cooperation and coordination between the U. S. and Canada. There is a tremendous opportunity for our countries to continue that relationship. The international nature of power transactions and the similar market restructuring and developments that are occurring in both Canada and the U.S. will increase the need for cross-border collaboration.

FERC recognized this need in our Order No. 2000 on Regional Transmission Organizations issued in December 1999. In this broad and far-reaching rulemaking, the Commission stated its intention that all transmission-owning entities in the United States should participate in independent RTOs in a timely manner. An example of an RTO-like entity would be the Ontario IMO, which I believe is similar to the independent system operators (or ISOs) that exist in the U. S.

We have encouraged the participation by Canadian entities in the formation of RTOs. For instance, we found that since electricity trading regions exist across national borders, the involvement of Canadian entities would be beneficial to both countries. Several Canadian entities participated in our rulemaking process and provided helpful

comments to the Commission. Our Final Rule acknowledged the sovereign authority of Canadian governments over Canadian entities and transactions that take place in Canada.

Nevertheless, we continue to believe that expansion of electricity trade in the North American bulk power market will require that regional institutions, such as RTOs, include all market participants so that everyone will enjoy direct access to market information and the benefits of regional coordination. We were pleased to receive helpful input from several Canadian entities during this process and we look forward to a continuing relationship with them. It makes sense to me that American and Canadian markets work cooperatively with each other, to plan together for expansion, congestion management and bulk power pricing. We must remember that these are natural transmission regions and markets that do not necessarily stop at the border. We welcome the opportunity to continue to work with our Canadian friends in developing energy markets that work in a manner that is mutually beneficial to everyone involved.

The opportunities we have now for mutual cooperation and collaboration on these energy issues are stronger than ever. I am certain that our two countries will take advantage of these opportunities in order to develop efficient regional—and international—markets.